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Nos. 128, 129, 130

In the Supreme Court of the United States

OCTOBER TERM, 1929

THE UNITED STATES, PETITIONER
v.
AMERICAN CAN COMPANY

THE UNITED STATES, PETITIONER
v.
MISSOURI CAN COMPANY

THE UNITED STATES, PETITIONER
v.
DETROIT CAN COMPANY

ON WRITS OR CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES

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OPINIONS BELOW

The opinion of the District Court for the District of New Jersey (R. 78–81) is reported in 20 F. (2d) 970. The opinion of the United States Circuit

Court of Appeals (R. 133–135) is reported in 31 F. (2d) 730.

JURISDICTION

The judgments of the United States Circuit Court of Appeals (R. 136–137) were entered March 5, 1929. Petitions for certiorari to review the judgments were filed June 4, 1929, and granted by this Court on October 14, 1929. (R. 137–138.) The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the correction by the Commissioner of Internal Revenue of the valuation of the inventories of tin plate in respondents' returns made on the accrual basis constituted such a rejection of the basis on which respondents' accounts were kept as to render it necessary under Section 13 (d) of the Revenue Act of 1916 to compute their income on the basis of cash receipts and disbursements.

2. Assuming that the Commissioner in changing the valuation of respondents' inventories has rejected respondents' accrual basis of accounting, does such a rejection made by the Commissioner herein in determining that an additional assessment was due for the year 1917 entitle respondents to a recovery of taxes paid on their returns filed on the accrual basis in the absence of a finding that such accrual basis did not reflect their true income?

3. Assuming that, because of the action of the Commissioner, respondents are entitled to have their income computed on the basis of cash receipts and disbursements, can their income be correctly computed on such basis without the use of inventories?

STATUTES AND TREASURY DECISION INVOLVED

The pertinent portion of the Revenue Act of 1916, c. 463, 39 Stat. 756, 771, reads:

> SEC. 13. (a) The tax shall be computed upon the net income, as thus ascertained, * * *;
>
> * * * * *
>
> (d) A corporation, joint-stock company or association, or insurance company, keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned;
>
> * * * * *

The pertinent portion of the Revenue Act of 1917, c. 63, 40 Stat. 300, 305, reads:

> SEC. 206. That for the purposes of this title the net income of a corporation shall be ascertained and returned * * * (c) for the taxable year upon the same basis and

in the same manner as provided in Title I of the Act entitled "An Act to increase the revenue, and for other purposes," approved September eighth, nineteen hundred and sixteen, as amended by this Act * * *.

Treasury Decision No. 2609 promulgated December 19, 1917:

(1) For the purposes of income and excess-profits tax returns, inventories of merchandise, etc., and of securities will be subject to the following rules:

A. Inventories of supplies, raw materials, work in process of production, and unsold merchandise must be taken either (a) at cost or (b) at cost or market price, whichever is lower, provided that the method adopted must be adhered to in subsequent years, unless another be authorized by the Commissioner of Internal Revenue.

* * * * *

C. Gain or loss resulting from the sale or disposition of assets inventoried as above must be computed as the difference between the inventory value and the price or value at which sold or disposed of.

(2) In all other cases inventories must be taken at cost or at value as of March 1, 1913, as the case may be.

STATEMENT

The American Can Company and its subsidiaries, Missouri Can Company and Detroit Can Company, respondents herein, were during 1917 engaged in the business of manufacturing and sell-

ing cans and other containers. They kept their accounts, made their returns, and paid their income and excess-profits taxes for the year 1917 and previous years upon the accrual basis. (R. 2, 87, 97, 107, 116, 126.) Additional assessments were thereafter made against the parent company for 1917 (R. 3), and were paid to the then collector, William H. Edwards, who had collected the original assessments. Thereafter a final audit resulted in further additional assessments for 1917, which were paid to another collector and are involved, not in the instant cases, but in certain other cases hereinafter mentioned. (R. 5.)

Respondents, in the conduct of their business, were required to keep on hand large stocks of tin plate, which was the most important material used by them. (R. 98, 116.) The market price of tin plate rose sharply in the early part of 1917 from $3.60 per base box to $7. Respondents took advantage of this sharp increase in value of stocks on hand by writing up as of January 1, 1917, to $7 per base box, their opening inventories of tin plate, which had cost them but $3.60 per box, and transferring so much of the inventory write-up as was calculated to represent respondents' normal stocks of tin plate to the so-called "inventory constant" accounts set up for the first time in that year.

(The above facts showing the manner in which respondents' books of account reflected this write-up of tin plate in inventory transfer to their "inventory constant" accounts, and the reasons there-

for, are not included in the findings made by the District Court, but are supported by uncontradicted evidence in the record (R. 28, 48, 49) which has been adopted by the Circuit Court of Appeals in its opinion (R. 133) as proved facts.)

This bookkeeping entry had the effect of increasing the cost of goods sold as returned by the respondents and resulted in an understatement of net income to the extent of the amounts credited to their respective "inventory constant" accounts. The net income of the American Can Company was thus understated by $4,722,500 (R. 7), the net income of the Missouri Can Company by $168,500 (R. 7), and the net income of the Detroit Can Company by $70,000. (R. 8.)

The Commissioner of Internal Revenue eliminated this artificial inflation of the cost of goods sold (R. 7–8), increased respondents' net income by the amounts in the "inventory constant" accounts, and made further additional assessments, as follows: American Can Company, $3,383,481.46 (R. 4); Missouri Can Company, $10,110 (R. 98); Detroit Can Company, $4,200. (R. 117.) Respondents filed claims to abate such further additional assessments and filed claims for refund of so much of the taxes theretofore paid as exceeded what they contended was their true tax liability computed on the cash receipts and disbursements basis. The grounds set forth in the claims, which are also the grounds upon which these suits are based, were that the Commissioner, in correcting the valuation of inventories used in the computation of the cost of goods sold,

rejected the basis upon which their accounts were kept and their returns filed, and that as the result of the action of the Commissioner they became entitled, under the provisions of Section 13(d) of the Revenue Act of 1916, to have their income computed on the cash receipts and disbursements basis, and that on such basis respondents' tax liability was not only less than that computed by the Commissioner but was less by $2,719,159.16 than the taxes paid by them on their returns as filed. (R. 79–80.)

The respondents instituted actions against the United States in the District Court for the District of New Jersey under Section 24(20) of the Judicial Code for recovery of the amount of taxes paid to William H. Edwards, former Collector, in excess of what they contended was due. (R. 1, 97, 115.) That court upheld the contentions of the taxpayers that their tax liability should be computed on the cash receipts and disbursements basis. (Exhibit P–7 (R. 59), Exhibit P–8 (R. 65), Exhibit P–9 (R. 66); R. 90, 109, 127.)

Respondents' income on the cash basis adopted by the court was computed without the use of inventories, although it appears that the inventories on hand at the end of the year exceeded in quantity those on hand at the beginning of the year. (R. 69.) The calculation upheld by the court was merely a statement showing the excess of income receipts over income expenditures, each class having no necessary relation to the other. The District

Court has not made findings that the computation of income on the cash basis adopted by it was arrived at without the use of inventories, but this fact was established by the testimony of one of respondents' witnesses (R. 50), and requests for such a finding were made by the Government in each case and were denied. (R. 84, 85, 104–106, 123, 124.)

The cases were tried together in the District Court. Upon the conclusion of the trial there the Government made timely motions for judgments in its favor, which were denied and exceptions were duly taken and allowed. (R. 59.) The Government requested certain express findings of fact in each case, and exceptions were duly taken and allowed to the court's refusal to make the findings requested. (R. 81–85, 102–106, 121–124.) Timely exceptions were also taken and allowed to the findings of fact and conclusions of law as made and filed by the District Court in each case. (R. 91, 109, 127.)

The Circuit Court of Appeals for the Third Circuit affirmed the judgments of the District Court.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred—

I. In holding that the action of the Commissioner in these cases amounted to a rejection of the accrual basis upon which basis the respondents kept their accounts and upon which their returns were made so as to entitle respondents to have their income for the year 1917 computed on the basis of cash receipts and disbursements.

II. In holding that respondents were entitled, as a matter of right, to have their taxes computed on the basis of cash receipts and disbursements in the absence of a finding that the accrual basis, which the Commissioner is said to have rejected, did not in fact reflect their true income.

III. In holding that the respondents' income computed upon a cash receipts and disbursements basis could be correctly determined without showing by the use of inventories the cost of goods sold.

SUMMARY OF ARGUMENT

I. The question whether the correction made by the Commissioner in respondents' returns amounted to a rejection of the basis upon which respondents' accounts were kept involved the application of reasoning to the uncontroverted facts and hence presented a question of law which is reviewable here. If material, the question whether the findings of the amounts of respondents' tax liabilities when computed on the cash basis are supported by evidence is also open to review.

II. The entire dispute arises out of the Commissioner's treatment of the inventory item. Respondents kept their accounts on the accrual basis and treated all items consistently with the exception of the inventory of tin plate. The market price of tin plate rose sharply in the early part of 1917 from $3.60 per base box to $7. Respondents took advantage of this increase in value of stocks on hand by writing up as of January 1, 1917, to $7 per base

box their opening inventories of tin plate which had cost them but $3.60 per box. Since the effect of this was to increase the cost of goods sold as shown on their returns and resulted in an understatement of net income, the Commissioner eliminated this artificial inflation of the cost of goods sold and made additional assessments. The courts below have held that this action of the Commissioner amounted to a rejection by him of the basis upon which respondents' accounts were kept and that the necessary consequence of this rejection was to require that the tax be computed on the cash basis. In a case involving the identical facts the Circuit Court of Appeals for the Second Circuit has held to the contrary. We submit that the decision of the court below puts too narrow a construction upon the statute and sanctions a result which Congress never intended.

The statute authorizes the filing of a return on the basis of the taxpayer's accounts unless such basis does not clearly reflect his income. Respondents kept their accounts and filed their returns on the accrual basis. Even if it should be held that the Commissioner rejected the basis upon which respondents' accounts were kept, we submit that since there is no finding that the basis upon which respondents kept their accounts and filed their returns did not clearly reflect income, the findings do not support the judgment.

III. The findings of the amounts of respondents' net incomes on the cash basis are not supported by

evidence, since it clearly appears that the cost of all tin plate paid for during the year has been charged as an expense against the receipts from finished products in which only a part of such tin plate was used, thus causing respondents' incomes to appear to be less than the actual amounts. Furthermore, in the computations of respondents' incomes on the cash basis no attempt was made to reconcile cash payments in 1917 with accrued liabilities for 1916, with the result that items which were deducted in 1916 when respondents reported on the accrual basis have been again deducted when computing respondents' 1917 income on the cash basis.

ARGUMENT

I

THIS COURT IS NOT PRECLUDED FROM DETERMINING WHETHER THE BASIS UPON WHICH THE RESPONDENTS KEPT THEIR ACCOUNTS CLEARLY REFLECTED THEIR INCOME, OR FROM DETERMINING WHETHER THE RESPONDENTS PROVED WHAT THEIR NET INCOME ON THE CASH BASIS WAS, IF THE QUESTION OF NET INCOME ON THE CASH BASIS BECOMES IMPORTANT

Before discussing the merits of the cases, we wish to consider preliminary questions dealing with the proper scope of the review of the decision of the District Court.

These cases were brought in the District Court under Section 24(20) of the Judicial Code, often referred to as the "Tucker Act."

The petitions allege that the Commissioner objected to the basis upon which respondents "had

valued their inventories of tin plate and determined their net incomes for 1917, and on or about March 7, 1921, the Commissioner of Internal Revenue issued and mailed a letter to the [respondents], of which a copy is hereto attached and made a part hereof marked 'Exhibit A,' in which he stated in substance that the basis on which the [respondents] had valued their inventories of tin plate and determined their net incomes for 1917 was not correct, undertook to revalue their inventories of tin plate, and redetermine their net incomes upon a different basis." (R. 3–4.) This allegation was admitted by the answer. (R. 15.)

Each of the petitions instituting suit in the District Court contains an allegation substantially in the form of the following, which occurs in the suit brought by the American Can Company (R. 5–6):

> On information and belief that the Commissioner of Internal Revenue ruled and determined that the basis upon which the plaintiff and its said subsidiary companies valued their inventories of tin plate and determined their net incomes for 1917 did not clearly reflect their incomes and was not authorized or permitted by the revenue acts applicable to 1917 or the regulations made thereunder, that their incomes for 1917 should not be determined upon the basis upon which they kept their accounts and made their returns and their income and excess-profits taxes for 1917 should not be computed upon their incomes as returned.

As to these allegations, the answer in each case "admits the making of the regulations by the Commissioner of Internal Revenue and his rulings and determinations, but denies that the assessment and collection of the taxes was erroneous and illegal." (R. 15.)

A letter from the Deputy Commissioner to the Can Company (Exhibit A to petition) notified respondents of the assessment of an additional tax which is based solely on an alteration by the Commissioner of the inventory item returned by respondents. No other change was made, and this letter contained no statement to the effect that the Commissioner ruled that the basis upon which respondents kept their accounts did not clearly reflect their income. (R. 7.)

No evidence was adduced by either party of any other or further action taken by the Commissioner.

The District Court, under the heading "Findings of Fact," said (R. 87):

> The Commissioner of Internal Revenue ruled and determined that the basis upon which the plaintiff and its domestic affiliated corporations kept their accounts and made their Federal income and excess profits tax returns for 1917 did not clearly reflect their incomes, that their incomes for 1917 should not be determined upon such basis and that their income and excess profits taxes for 1917 should not be computed upon their incomes as returned.

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It is clear from the record that this "Finding" rests wholly upon the court's view that a change by the Commissioner of a single item in respondents' returns on the accrual basis constituted a rejection of the entire returns and that because of this single item the returns of the respondents and the assessment of their taxes should be made on the basis of cash receipts and disbursements under Section 12.

We submit that this finding is in the nature of a conclusion of law, and that under *United States* v. *Pugh,* 99 U. S. 265; *The Edwin I. Morrison,* 153 U. S. 199, 216; *Sun Mutual Ins. Co.* v. *Ocean Ins. Co.,* 107 U. S. 485, it is open to review in this Court. In the *Pugh case* this Court said (pp. 270–271):

> Confessedly, the court has found all the facts which have been directly established by the evidence. These facts are not evidence, in the sense that evidence means the statements of witnesses or documents produced in court for inspection. They are the results of evidence, and whether they establish the ultimate fact to be reached is, if a question of fact at all, to say the least, in the nature of a question of law. * * *
>
> * * * To avoid misapprehension in the future, we take this opportunity to say that we not only think such a judgment may be reviewed here if the question is properly presented, but that when the rights of the parties depend upon circumstantial facts alone, and there is doubt as to the legal effect of the facts, it is the duty of the court, when requested, to so frame its findings as to put the doubtful

> question into the record. This would not require us on the appeal to decide upon the weight of evidence. That is done in the court below, when the particular fact is found which the evidence tends to prove. The effect of mere evidence stops when the fact it proves is established. After that the question is as to the effect of the fact; and when the evidence in a case has performed its part and brought out all the facts that have been proved, these facts thus established are to be grouped, and their legal effect as a whole determined.

This seems to be the generally accepted rule. In *Bianchi* v. *Vere,* 17 F. (2d) 22, 25, the Circuit Court of Appeals for the First Circuit held that a finding of the Supreme Court of Porto Rico which was based upon inferences drawn from uncontroverted facts "does not have the weight in this court that a finding of fact would have." The Circuit Court of Appeals reached a conclusion contrary to the finding of the court below and, since it was controlling, reversed the judgment. Certiorari was denied by this Court, 274 U. S. 752.

The State courts also recognize the rule that appellate courts may treat as conclusions of law findings which are the result of reasoning and inferences. *Woodward* v. *Carson,* 208 Pa. 144, 145; *Commonwealth T. I. & Tr. Co.* v. *Seltzer,* 227 Pa. 410, 416; *Davies's Estate,* 289 Pa. 579, 584; *Fidelity-Phila. Tr. Co., Ex.* v. *L. V. C. Co., Aplnt.,* 294 Pa.

47, 66; *Blaha* v. *Borgman*, 142 Wis. 43; *Caines* v. *Sawyer*, 248 Mass. 368, 372; *A. T. Stearns Lumber Co.* v. *Howlett*, 260 Mass. 45, 59.

The mere circumstance that this conclusion of law was included by the District Court under the heading "Findings of fact" is in no way determinative. *P. H. & F. M. Roots Co.* v. *United States* (C. C. A. 7th), 17 F. (2d) 337; *Lee Hardware Co.* v. *United States* (C. C. A. 8th), 25 F. (2d) 42; *United States* v. *Tinsley* (C. C. A. 4th), 68 Fed. 433, 434; *O'Reilly* v. *Campbell*, 116 U. S. 418. The findings of fact should not include conclusions of law. *Jackson* v. *United States*, 230 U. S. 1, 18.

Even if the above finding is considered as a finding of fact, it is a finding of ultimate fact. Such a finding would seem to be open to review in this Court to determine whether it is supported by evidence. In *Hathaway & Co.* v. *United States*, 249 U. S. 460, 463, this Court said:

> The Court of Claims found: "There was no unreasonable delay on the part of the Government in approving the contract." This finding, like one of reasonable value, *Talbert* v. *United States*, 155 U. S. 45, 46, is a finding of an ultimate fact by which this court is bound, *unless it appears that the finding was made without supporting evidence* * * *. (Italics ours.)

Although the record in the *Hathaway case* discloses that there was no evidence before the court, two of the cases therein cited (*Cramp* v. *United*

States, 239 U. S. 221; *United States* v. *Clark,* 96 U. S. 37) disclose that in those cases some evidence was brought up which was reviewed here. See also *Collier* v. *United States,* 173 U. S. 79. The Circuit Court of Appeals for the Fifth Circuit also holds the view that the evidence may be reviewed in a suit under the Tucker Act by a party who has made requests for findings of fact and taken exceptions to the court's refusal to make such findings. *Blockton Cahaba Coal Co.* v. *United States,* 24 F. (2d) 180.

We submit, whatever may previously have been the rule here with respect to the review of evidence in Tucker Act cases, that since the enactment of the Jurisdictional Act of February 13, 1925, such a review may be had, as in other cases tried without a jury.

Section 4 of that Act provides that in suits tried in the District Courts wherein they exercise concurrent jurisdiction with the Court of Claims "the judgments shall be subject to review in the circuit courts of appeals like other judgments of the district courts" and that "sections 239 and 240 of the Judicial Code shall apply to such cases in the circuit courts of appeals as to other cases therein."

At the conclusion of the evidence petitioner moved for judgment in each case and duly excepted to its denial (R. 59, 85–86, 106, 125) and assigned the court's rulings as error. (R. 94, 112, 131.) Accordingly the District Court's ruling on peti-

tioner's motion, which was in the nature of a demurrer to the evidence, is open to review under Section 700 R. S., U. S. Code, Title 28, Sec. 875, to determine whether, as a matter of law, the court erred in denying the motion for judgment. The petitioner filed requests for findings and conclusions of law (R. 81, 102, 121) and was allowed exceptions to the findings of fact and conclusions of law adopted by the court. (R. 91, 109, 127.) This was an exception to a ruling of the court in the progress of the trial within the language of Section 700 R. S., which presents the question of law whether there is any evidence to support the findings. *Maryland Casualty Co.* v. *Jones,* 279 U. S. 792; *St. Louis* v. *Western Union Telegraph Co.,* 148 U. S. 92, 96; *Bank of Waterproof* v. *Fidelity & Deposit Co.,* 299 Fed. 478, 482; *Griffin* v. *Thompson,* 10 F. (2d) 127, 128; *Sartoris* v. *Utah Construction Co.,* 21 F. (2d) 1, 2; *Thompson-Starrett Co.* v. *La Belle Iron Works,* 17 F. (2d) 536.

It would seem, therefore, that the foregoing principle, applicable to proceedings in error generally, is equally applicable to the judgments herein against the United States. Unlike cases in the Court of Claims, these cases are heard in the District Courts by a single judge and there was no reason to believe that Congress intended to limit the review of the decision of a single judge in the same manner as the decision of the five judges of the Court of Claims. See *Luckenbach S. S. Co.* v. *United States,* 272 U. S. 533, 537.

Furthermore, even if the rule be that in the ordinary case this Court will not review the evidence for the purpose of ascertaining whether it supports the findings, it should not be applied here, because of an extraordinary situation created by the fact that in the case of *American Can Company* v. *Bowers,* involving the same tax for the same year, and the same taxpayer, the District Court for the Southern District of New York and the Circuit Court of Appeals for the Second Circuit reached a conclusion diametrically opposed to the decisions of the courts below in the instant cases. See *Sanitary Refrigerator Co.* v. *Winters,* 280 U. S. 30, 35–36.

If this Court should decide that the respondents' income should be computed on the cash basis, we contend that the evidence adduced before the District Court was insufficient to sustain the finding as to respondents' true income on the cash basis. For the above reasons, we submit that if this question becomes material, this Court may determine whether the evidence was sufficient.

II

RESPONDENTS' TAXES WERE CORRECTLY ASSESSED BY THE COMMISSIONER ON THE ACCRUAL BASIS, WITH A REVALUATION OF THE INVENTORIES OF TIN PLATE

On the question here involved there is a direct conflict between the Circuit Court of Appeals for the Third Circuit in the instant cases and the Circuit Court of Appeals for the Second Circuit in *American Can Co.* v. *Bowers.* (The opinion of the latter court, filed November 11, 1929, is printed in

an appendix, pp. 36–46, *infra.*) This is not the ordinary case of conflict in principle. It is unusual in that the conflict relates to the tax liability of the same taxpayer for the same tax year arising out of identical facts.

In these cases respondents, who had kept their books and made their returns of income upon the accrual basis for the year 1916 (R. 47–48), also kept their books and made returns of their income on the accrual basis for the year 1917, the year here involved. For this year they reported that their consolidated net income was $17,994,400.46. (R. 68, 87.) In arriving at that figure, respondents valued their inventory of tin plate at a constant figure regardless of changes in cost or market value. (R. 86.) This "inventory constant" was the result of writing up the value of the 1916 closing inventory and tin plate purchased in 1917 at $3.60 per box, to $7 per box. (R. 49.) The Commissioner objected to this method of valuing the tin plate (R. 4, 7), and corrected the inventory item to comply with his regulations (T. D. 2609), which required that they be kept at cost or market value, whichever was lower. This action of the Commissioner had the effect of increasing the consolidated net income to $24,949,688.51. (R. 4.) Respondents assert that the Commissioner thereby rejected the accrual basis, and that a return on the basis of cash receipts and disbursements was therefore required, resulting in a net income, as found by the court, of $13,231,054.52. (R. 66, 89.)

The views of the Government as to the fallacy of the contention of the respondents can not be stated better than in the language of the Circuit Court of Appeals for the Second Circuit in the companion case against the Collector, where it is said:

> The appellee argues that "basis" as used in the statute, includes every process and every method used in determining any factor which affected the amount of the net income stated in the return and requires the consideration of every figure in the return which relates to the net income. Having made their returns, in accordance with such a basis, appellants say there is no occasion for reconciliation of the net profits as per their books with the Federal tax return of 1917. They say that the tax "shall be computed upon the income as so returned" and in construing the basis as used in Sec. 13 (d) that the Commissioner must compute the tax on the income as returned without correction. But the section provides for the computation of the tax upon the income "as so returned" upon the basis upon which the accounts are kept instead of income computed upon the basis of actual receipts and disbursements. The requirement of Section 10 was intended to reflect the true income of the taxpayer. If it does, the return may stand as filed upon the accrual basis. If not, the Commissioner may still, treating the return as on an accrual basis, make corrections on such basis as he would if it were filed upon a cash basis. Here the Commissioner made no change as to the accrual system of accounting. He dis-

allowed the inflation of cost for the tinplate—a sum which did not truly represent its cost—and declined to permit the increase by means of bookkeeping entries. In so doing, he did not change the method of bookkeeping; his act was not an inconsistent treatment of any items on the returns; it was merely a correction of an item incorrectly stated on the same accrual basis. He revalued the inventories in accordance with the truth and his valid regulations. He disregarded the later writeups setting up the "inventory constant" which did not state the truth as to the cost of the tinplate. It must always be borne in mind that in keeping accounts they must truly reflect the costs and disbursements which are either paid or accrued and which may lawfully be deducted. The determination of the value to be placed upon an inventory has no relation to the principle or theory affecting the determination of when income is deemed to be received and when expenses are deemed to be incurred. The valuation used in taking the income or in setting up a reserve against the contingencies of future inventory losses has no reference to the basis of accounting with which the statute concerns itself, and does not amount to a basis of accounting within the purview of Section 13.

The reference in Section 13 (d) to "any basis other than that of actual receipts and disbursements" means an equally basic system of accounting which a taxpayer may employ "unless such other basis does not clearly reflect its income." It has

reference to the two fundamental systems of accounting, generally known as the cash basis and the accrual basis. See *United States* v. *Anderson,* 269 U. S. 422, 440; *Reinecke* v. *Gardner,* 277 U. S. 239, 244. This is shown not only by the language of the Act itself but also by the following excerpt from the report of the Ways and Means Committee of the House (H. Rep. No. 922, 64th Congress, First Session, p. 4), respecting the enactment of Section 13 (d):

> As two systems of bookkeeping are in use in the United States, one based on the cash or receipt basis and the other on the accrual basis, it was deemed advisable to provide in the proposed measure that an individual or corporation may make return of income on either the cash or accrual basis, if the basis selected clearly reflects the income.

The case of *Aluminum Castings Co.* v. *Routzahn* (C. C. A. 6th), 31 F. (2d) 669, now pending in this Court upon writ of certiorari (No. 198, October term, 1929), is to the same effect, the court saying (p. 669) that the return contemplated by Section 13 (d) was the return "ordinarily denominated a return upon the accrual basis."

But while Congress authorized the return of income upon the accrual basis, the statute evinces no purpose to limit the Commissioner's power to correct such returns. The whole purpose of the statute is to levy a tax upon the true net income and all the provisions with respect to returns must be

read in the light of this purpose. In *United States* v. *Mitchell,* 271 U. S. 9, 12, this Court said:

> Notwithstanding the option given taxpayers, it is the purpose of the Act to require returns that clearly reflect taxable income.

In order to effectuate such a purpose, it is necessary that the Commissioner have power to make corrections in all returns irrespective of the basis upon which they are made. Section 14 (a) provides that in cases of erroneous, false, or fraudulent returns the Commissioner shall make a return and Section 14 (b) provides that "the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue * * *." With respect to this section, the Circuit Court of Appeals for the Second Circuit pertinently remarked in the case of *American Can Co.* v. *Bowers, supra:*

> The term "returns" necessarily is generic and embraces all returns whether they be upon a basis of cash or accrual system of bookkeeping.

The result of the decision in the instant case is to deny the Commissioner the right to correct returns on the accrual basis. On the other hand, in *Vang* v. *Lewellyn,* 35 F. (2d) 283, the same court passed on a case involving a change made by the Commissioner in a return on the accrual basis, similar in principle to the one made here, without suggestion

that the change required the computation of the tax on the cash basis. In *United States* v. *Anderson,* 269 U. S. 422, 442–443, the taxpayer was on the accrual basis and the controversy concerned the right of the Commissioner to correct the return by the disallowance of a deduction. His right to correct a return on the accrual basis was assumed without discussion. Other courts have similarly assumed such a right. *Aluminum Castings Co.* v. *Routzahn, supra; Chicago Frog & Switch Co.* v. *United States,* decided by the Court of Claims June 3, 1929, not yet officially reported; *Western Dry Goods Co.* v. *United States,* decided by the District Court for the Western District of Washington July 3, 1929, not yet officially reported. See also *Appeal of Tel-Electric Co.,* 1 B. T. A. 434; *Stanfield* v. *Commissioner,* 8 B. T. A. 787, 823.

If the true income is to be shown for a fixed annual period, it is also necessary that the Commissioner have the power to insist that a taxpayer who voluntarily adopts the accrual basis shall consistently follow that basis. Treasury Decision 2433 provides that under Section 13 (d) it will be permissible to file returns on the accrual basis and contains the following statement:

> This ruling contemplates that the income and authorized deductions shall be computed and accounted for on the same basis and that the *same practice shall be consistently followed year after year.* (Italics ours.)

Parts of this Treasury Decision have received the approval of this Court in *United States* v. *Anderson*, 269 U. S. 422, and *American National Co.* v. *United States*, 274 U. S. 99. See also *W. S. Barstow & Co.* v. *Bowers*, 15 F. (2d) 75, 77; *Robert P. Hyams Coal Co.* v. *United States*, 26 F. (2d) 805, 809.

The theory that if the Commissioner undertakes to correct a return made on the accrual basis, he must then go further and compute the tax on the cash basis is obviously unsound and would not satisfy the requirement that whatever system be adopted it must be consistently followed from year to year. With respect to this the Circuit Court of Appeals for the Second Circuit said in *American Can Co.* v. *Bowers, supra:*

> We find no basis for the argument of the appellants, that the Commissioner's sole authority was to compute income on a cash basis. With the power of correction, as above pointed out, in the Commissioner, he may properly correct and compute income on returns filed on an accrual basis.

The valuation at which inventories are taken obviously has nothing to do with the "basis" of accounting as that term is used in Section 13 (d). While affecting the amount of net income because it enters into the calculation of the cost of goods sold, the valuation placed upon inventories does not involve the basis applied in the treatment of items of income and expenditures. The valuation of in-

ventories thus has no bearing on whether in keeping its accounts a corporation deems its income received and expenses paid only when cash is actually received or disbursed, or when income is accrued and expenses incurred. If one company should value its inventory on the basis of cost or market, whichever is lower, in accordance with the Commissioner's regulation, while another company in the same business should use a different valuation, it would be absurd to require that for this reason the one should be taxed on the accrual basis and the other on the cash basis.

The statute must be given a reasonable construction with the purpose of effectuating the general intent of Congress, even if the literal meaning of the language has to be rejected. *Carbon Steel Co.* v. *Lewellyn,* 251 U. S. 501, 505, 506.

Both the court below and the Circuit Court of Appeals for the Second Circuit in the companion case against the Collector have held that the respondents' method of treating their inventories resulted in distorting their income. The court below held (R. 134) that—

> the reason why the basis used by the plaintiffs in making their return did not reflect their true net income was because of this "inventory constant," $7.00 per box, used in making the inventory of the stock of tin plate, regardless of cost or market value.

Respondents were artificially increasing the cost of finished products by the use of their inventory

constant and it has been held that the returns were erroneous to this extent only. The change made by the Commissioner corrected the only error without disturbing the basic accrual system of accounting so that it is entirely clear that the accrual system as corrected discloses respondents' true net income. Thus the purpose of the statute was carried out, and respondents are not entitled to require that their books be entirely rewritten upon a different basic system. As stated by the Circuit Court of Appeals for the Second Circuit in *American Can Co.* v. *Bowers, supra*:

> The Commissioner has but taxed income in declining to allow this alleged increase of cost. The taxpayer received a gain in the sale of its tinplate, when made into tin cans, to the extent of this increase. It was gain derived from capital and labor or from both combined.

Even if it should be held that the Commissioner rejected the basis upon which respondents' accounts were kept, we submit that the judgments must be reversed because the findings of the trial court are not sufficient to support them. Respondents kept their accounts on the accrual basis and filed their returns on the basis upon which their accounts were kept rather than upon the cash basis, pursuant to Section 13 (d). As the respondents have elected to file their returns and pay their taxes on the basis upon which their accounts were kept in the year in question and previous years, they can not change

to the cash basis, and have a judicial refund made of upwards of $2,719,159, including a substantial part of the taxes paid on their original returns, unless the accrual basis upon which they kept their accounts and filed their returns did not clearly reflect their true income. The burden of establishing all facts essential to the recovery is, of course, upon the respondents. *Botany Mills* v. *United States,* 278 U. S. 282; *United States* v. *Anderson,* 269 U. S. 422; *United States* v. *Mitchell,* 271 U. S. 9. For respondents to recover, it was essential for the trial court to find that the accrual basis upon which respondents' accounts were kept did not "clearly reflect" their income. The finding as to the Commissioner's ruling and determination (R. 87, 108, 126) falls far short of meeting this requirement. Respondents' right to have their taxes computed on the cash basis clearly depends, not upon the action taken by the Commissioner in the premises, but upon whether in fact the basis upon which the books were kept and the income returned clearly reflected respondents' true income. Section 13 (d) does not give the Commissioner the arbitrary right to reject a return filed on the basis upon which a taxpayer's accounts are kept. He may so reject the return only where the basis used does not clearly reflect true income. Likewise, a taxpayer who makes a return upon the basis upon which his accounts are kept may not have his tax computed on the cash basis unless the basis used did

not in fact reflect his income. There being no finding that respondents' accrual basis did not correctly reflect their true income, the findings of the District Court, we submit, are insufficient to support the judgments. *Reinecke* v. *Gardner,* 277 U. S. 239, 245.

III

EVEN IF THE STATUTE REQUIRES THE TAX IN THESE CASES TO BE COMPUTED ON THE CASH BASIS, THE FINDINGS OF THE AMOUNTS OF TAXES DUE ON THE CASH BASIS ARE NOT SUPPORTED BY EVIDENCE

If this Court decides that the statute does not require that respondents' taxes be computed on the cash basis, this point is immaterial.

The trial court made findings (R. 87–90, 108–109, 126–127) to the effect that respondents' incomes on the cash basis were correctly stated in Exhibits P–7 and P–9 (R. 59, 66) and the judgments were based on such findings. The findings were duly excepted to (R. 91, 109, 127), and an exception was also taken to the court's ruling denying petitioner's motion for judgment in each case. (R. 85–86, 106–107, 125.) A brief analysis of the record establishes that the trial court's findings as to respondents' income on the cash basis are not supported by evidence. The evidence shows that the cash computation was arrived at in utter disregard of fundamental principles of Federal income taxation, of the provisions of the statute and regulations, and of elementary business principles.

The so-called net income shown in respondents' cash computation merely represents the excess of

cash receipts over cash disbursements, as shown by the cash books. (R. 37–38; Ex. P–7, R. 59–64; Ex. P–9, R. 66–67.) The computation does not purport to set forth the cost of the goods which when sold produced the income receipts; and the net income shown thereon was arrived at without the use of inventories (R. 50) in violation of provisions of Articles 91 and 92 of Regulations 33, Revised. Thus, among the deductions from gross income there have been included as "expenses" all purchases of tin plate paid for during the year, regardless of whether such tin plate was used during that year. Respondents made heavy purchases of tin plate during 1917, their closing inventories being larger than their opening inventories by some 700,000 base boxes. (Ex. D–1, R. 69.) The computation also includes, as deductions from gross income, bills payable which had accrued in 1916, but which were paid in 1917. These liabilities constituted 1916 deductions to respondents whose returns were filed in that year also on the accrual basis, and by these judgments they are again given the benefit of the same deductions, for concededly no effort was made to reconcile the returns and thus avoid the duplications. (R. 52, 53.)

It is clear from the foregoing that Exhibits P–7 and P–9 fail to reflect respondents' true income either on the cash basis or on any other basis. The computation amounts to no more than the ascertainment of the difference between the amount of

cash actually received and the amount of cash actually paid out in 1917.

True net income of a business, embracing the manufacture and sale of finished products, can not be accurately determined, either on the cash basis or on the accrual basis, by treating receipts from the sale of finished products as gross income without ascertaining the true cost of the goods so sold. *United States* v. *Anderson,* 269 U. S. 422, 440, *supra.* Where more raw material is purchased in any year than is actually used in the manufacture of the finished products sold during that year, it is obvious that the difference between the cost of all and the receipts from the sale of part will be less than the actual profit upon the part sold. It has been shown that respondents bought more tin plate in 1917 than was used during the year and that the calculation of their net income on the cash basis has been made by deducting the cost of all of the tin plate from the proceeds of the sale of the part made into finished products. Thus the income shown by respondents' computations (P–7 and P–9), from which the District Court took the figures used in its findings, is less than respondents' actual income.

It is, of course, impracticable for mercantile and manufacturing corporations to so keep their accounts as to record the cost of the manufacture and sale of each unit of merchandise sold. The same result is accomplished, however, by computing the cost of sales in bulk through the use of inventories.

Thus the computation of the cost of goods sold is made by adding to the purchases made during the year the inventories at the beginning of the year, and deducting therefrom the inventories at the end of the year. That is the method prescribed by the Regulations. (Reg. 33, Revised, Art. 91, 92.) That these Regulations are valid and apply to all returns, whether filed on the cash or the accrual basis, follows from this Court's decisions in the cases of *Doyle* v. *Mitchell Bros. Co.,* 247 U. S. 179, and *Hays* v. *Gauley Mt. Coal Co.,* 247 U. S. 189, where similar regulations under the Corporation Excise Tax Act of 1909, which imposed a tax on the cash basis, were held valid. While these cases involved the sale of capital assets, this Court recognized the necessity of deducting from the gross proceeds of the sale the cost of the assets sold, in order to determine taxable gain. The regulations promulgated by the Commissioner under the 1909 Act, which required the use of inventories by manufacturing companies, were used to illustrate the proper method of determining gross income:

Regulations as to the use of inventories, similar to those promulgated under the 1909 Act, which received the approval of this Court, were promulgated under the 1913 Act, which Act also imposed a tax essentially on the cash basis, and again in Regulations under the 1916 and 1917 Acts. (Regulations 33, Articles 104, 105, 106, 161; Regulations 33, Revised, Articles 91, 92.) These regula-

tions apply to corporations filing on the cash, as well as to those filing on the accrual, basis.

Authority to require inventories whenever necessary was thereafter written into the Revenue Acts, Section 203 of the Revenue Acts of 1918 and 1921; Section 205 of the Revenue Acts of 1924 and 1926; Section 22 (c) of the Revenue Act of 1928. In those sections Congress has recognized that inventories are appropriate in the computation of net income and has not restricted their use to the accrual system. With respect to these regulations, the Circuit Court of Appeals for the Second Circuit said in *American Can Co.* v. *Bowers, supra:*

> Indeed, the appellants have failed to comply with the Departmental Regulation 33 (Revised), Articles 91 and 92, promulgated under the Act of 1917 which, in effect, require manufacturing and mercantile corporations to compute their income tax under the act in question through the use of inventories showing gross income as consisting of the difference between the price received for the goods sold and the cost of such goods as manufactured. Such regulations are valid, whether applied to a cash or accrual basis of return.

In *Chicago Frog & Switch Co.* v. *United States, supra,* the Court of Claims said:

> In ascertaining the income of concerns conducting a business such as that of plaintiff that requires large stocks to be carried, it

was absolutely necessary to have inventories made, and the provisions of the act could not be enforced without them.

CONCLUSION

In view of the foregoing we respectfully submit that the judgments of the court below should be reversed.

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DECEMBER, 1929.

APPENDIX

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

American Can Company, plaintiff-appellant, against Frank K. Bowers, Collector of Internal Revenue of the United States for the Second District of New York, defendant-appellee. American Can Company of Utah, plaintiff-appellant, against Frank K. Bowers, Collector of Internal Revenue of the United States for the Second District of New York, defendant-appellee. American Can Company of Massachusetts, plaintiff-appellant, against Frank K. Bowers, Collector of Internal Revenue of the United States for the Second District of New York, defendant-appellee. Missouri Can Company, plaintiff-appellant, against Frank K. Bowers, Collector of Internal Revenue of the United States for the Second District of New York, defendant-appellee.

Before: MANTON L. HAND, and SWAN, *Circuit Judges.*

Appeal from the District Court for the Southern District of New York. Actions by four plaintiffs to recover additional income and excess-profits taxes paid under duress. Judgments directed for the defendant; plaintiffs appeal. Affirmed.

Simpson, Thacher & Bartlett, Esqs., attorneys for appellants; Philip G. Bartlett, Esq., Graham Sumner, Esq., A. McCalman, Esq., of counsel.

Charles H. Tuttle, Esq., United States Attorney, Thomas J. Crawford, Esq., Special Asst. to the Attorney General; Edward Feldman, Esq., Assistant U. S. Attorney, of counsel.

MANTON, *Circuit Judge:*

The four appellants in these actions seek recovery of additional income and excess-profits taxes paid under duress for the year 1917 (39 St. 756; 40 Stat. 300). During the year 1917 the appellants kept their books and filed returns, as permitted by Sec. 13 (d) of the Revenue Act of 1917, showing a consolidated net income of $17,944,400.46 which included $60,010.50 as dividends. This income was increased, when audit was made by the Commissioner, and upon a reaudit was again increased so as to show a net income of $24,949,668.51, including the dividends.

Appellants are engaged in manufacturing and selling tin cans and other containers. It was necessary to have on hand constantly tin plate for their manufacture. In 1916 they paid $3.60 per box for tin plate. There was a sharp rise in price in the latter part of 1916 and it reached $7.50 in March, 1917. Appellants charged their customers at the rate of $7 per box, taking advantage of the market increase, and it is established that this increase in price of $3.40 per box was added to their usual manufacturing profit. They did not report this additional profit in their return so made. By journal entry, on January 31, 1917, the American Can Company wrote up as its inventory of raw materials and

goods in process by crediting its "inventory write-up" account by $5,403,406.70 and debiting the cost ledger the same amount. By journal entry it increased its inventory of finished products by crediting inventory write-up and debiting various finished products accounts by the same amount. Thus, by these entries, they brought the tin plate inventories from the actual cost of $3.60 per box up to $7. The total inventory write-up of this company amounted to $6,514,479.04, part of which is shown in the profits of the company, but $4,722,500 is claimed to represent the write-up of "normal stocks" and went into a special account set up for the first time in January, 1917, called "Inventory Constant." This account was set up by means of a journal entry whereby inventory write-up was debited and the new "inventory constant" account credited with this sum. Similar bookkeeping entries were made in the books of the other appellants in all involving the sum of $5,671,500. Thus, the book cost of goods was increased and the income understated.

The appellants reported the higher costs rather than the lower costs in their returns. This inflation of cost was disallowed by the Commissioner. It was proved that the appellants took their closing entries in their entirety, inclusive of normal stocks, for the purpose of profit and loss estimates, at cost or market, whichever were lower, and they were unable to establish that they had on hand at the end of 1917 any of the tin plate which had cost them $3.60 per box. The book elimination of this additional income was due to the write-up and the entries in other accounts. The "constant" accounts were liability accounts, and were constituted reserve accounts to take care of inventory losses in

future years. The treatment of the "constant" accounts is similar to the treatment in balance sheets of reserves for depreciation.

Appellants claim that this item does not constitute a part of their true consolidated net income as reported on an accrual basis. They contend that the same is not taxable income under the statute. Section 13 (d) of the act provides:

> A corporation * * * keeping accounts upon any basis other than that of actual receipts and disbursements, unless such other basis does not clearly reflect its income, may, subject to regulations made by the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, make its return upon the basis upon which its accounts are kept, in which case the tax shall be computed upon its income as so returned.

This act, as amended in part by the 1917 Act, was intended by Congress to extend the income tax as far as possible to all species of income. (*Heiner* v. *Columbia Trust Co.*, 275 U. S. 235; *Irwin* v. *Gavit*, 268 U. S. 161.) The section deals with a system of accounting where the taxpayer's accounts are kept on any basis other than actual receipts and disbursements. The income is presumed to have been received, even though not actually received and expenses incurred, even though not actually disbursed. The cash basis of accounting had theretofore been dealt with by Congress which referred to the actual receipts and disbursements. This new basis or system of accounting refers to other than a cash basis. It is based upon the fundamental principle upon which the corporate accounts are kept. If, when arriving at income, the bookkeeping

system contemplates that receipts and disbursements are deemed received and disbursed when the income accrued and the liabilities are incurred, then the basis of accounting is that of an accrual system, as pointed out by the Supreme Court in *United States* v. *Anderson* (269 U. S. 422). In construing Sec. 13, difficulties were involved in the preparation of income accounts on a strict basis of receipts and disbursements. Because of business complexity, when considering the acts of 1909 and 1913, it became necessary to authorize, by departmental regulation, a method of preparing returns not in terms provided by those statutes. This gave rise to the purpose of the act of 1916. (Secs. 12 (a) and 13 (d).) It was to enable taxpayers to keep their books and make their returns according to scientific accounting principles by charging against income earned during the taxable year, the expenses incurred in and properly attributable to the process of earning the income during that period, and to require the tax return to be made on that basis, if the taxpayer failed or was unable to make the return on a strictly cash received and disbursed basis.

The courts have held that in keeping accounts on an accrual basis, referred to in the statute, it was intended that there may be charged against income earned during the taxable period, the expenses incurred in and properly attributable to the process of earning income during the period. (*United States* v. *Anderson, supra; Aluminum Castings Co.* v. *Routzahn,* 31 Fed. (2d) 669.) Necessarily, net income, for tax purposes, is a conception of the income-tax statute and the amount arrived at is ascertained by deducting from the gross amount of income received by the taxpayer from all sources, the

specified deductions allowed to it by statute. For corporate purposes only, it may well be, on the other hand, that net income may be arrived at by the deduction of entries and accounts which are not permissible for purposes of taxation. (*Weiss* v. *Wiener*, 279 U. S. 333.) The appellee argues that "basis " as used in the statute includes every process and every method used in determining any factor which affected the amount of the net income stated in the return and requires the consideration of every figure in the return which relates to the net income. Having made their returns, in accordance with such a basis, appellants say there is no occasion for reconciliation of the net profits as per their books with the Federal tax return of 1917. They say that the tax " shall be computed upon the income as so returned" and in construing the basis as used in Sec. 13 (d) that the Commissioner must compute the tax on the income as returned without correction. But the section provides for the computation of the tax upon the income "as so returned" upon the basis upon which the accounts are kept instead of income computed upon the basis of actual receipts and disbursements. The requirement of S10 was intended to reflect the true income of the taxpayer. If it does, the return may stand as filed upon the accrual basis. If not, the Commissioner may still, treating the return as on an accrual basis, make corrections on such basis as he would if it were filed upon a cash basis.

Here the Commissioner made no change as to the accrual system of accounting. He disallowed the inflation of cost for the tin plate—a sum which did not truly represent its cost—and declined to permit the increase by means of bookkeeping entries. In

so doing, he did not change the method of bookkeeping; his act was not an inconsistent treatment of any items on the returns; it was merely a correction of an item incorrectly stated on the same accrual basis. He revalued the inventories in accordance with the truth and his valid regulations. He disregarded the later write-ups setting up the "inventory constant" which did not state the truth as to the cost of the tin plate. It must always be borne in mind that in keeping accounts they must truly reflect the costs and disbursements which are either paid or accrued and which may lawfully be deducted. The determination of the value to be placed upon an inventory has no relation to the principle or theory affecting the determination of when income is deemed to be received and when expenses are deemed to be incurred. The valuation used in taking the income or in setting up a reserve against the contingencies of future inventory losses has no reference to the basis of accounting with which the statute concerns itself, and does not amount to a basis of accounting within the purview of S13. The statute necessarily intends to impose a tax upon the true income when the return is on the accrual basis.

But the appellants contend that the Commissioner may not correct a return filed on an accrual basis in taxing income on such basis, but must either accept the return as made or restate the income on the cash basis. This is another way of saying that the computation of income may not be corrected if the return be on an accrual basis, and this is based upon the alleged lack of power on the part of the Commissioner to make correction. In order

to ascertain his profit, the taxpayer necessarily must deduct the actual cost, in the computation, from his sale price. In the departmental practice (Treasury Decision 2609), the Commissioner requires inventories to be taken at cost or market, whichever is lower, and such regulations accord with the best accounting practice and have met with approval in the subsequent revenue acts of 1918, 1921, 1924, 1926, and 1928. (See *United States* v. *Kemp,* 12 Fed. (2d) 7; *Chicago Frog & Switch Co.* v. *United States* (Court of Claims, June 3, 1929).)

The statute (S10) assessed the tax upon the total net income received from all sources by every corporation. Section 11 provides exemptions; S12 prescribes how the total net income shall be computed and authorizes deductions "from the gross amount of * * * income received within the year from all sources," such as ordinary and necessary expenses, losses sustained and charged off within the year, interest paid on indebtedness to the extent therein prescribed, and taxes paid within the year, except income and excess profits taxes. Subdivision (b) of S13 requires that every corporation shall be taxed after rendering a true and accurate return "containing such facts, date, and information as are appropriate and in the opinion of the Commissioner necessary to determine the correctness of the net income returned and to carry out provisions of this title * * *". Section 14 (a) provides that in cases of erroneous, false, and fraudulent returns, the Commissioner shall make a return upon information obtained as provided for, and S14 (b) provides that "the returns, together with any corrections thereof, which may

have been made by the Commissioner, shall be filed in the office of the Commissioner of Internal Revenue." The term "returns" necessarily is generic and embraces all returns whether they be upon a basis of cash or accrual system of bookkeeping. In his examination, the Commissioner was entitled to such information as would give him the entire income from all sources, less the statutory deductions to which the taxpayer was entitled. We find no basis for the argument of the appellants, that the Commissioner's sole authority was to compute income on a cash basis. With the power of correction, as above pointed out, in the Commissioner, he may properly correct and compute income on returns filed on an accrual basis.

It may not be argued that the provisions of S12 (a) which define taxable net income apply only to returns on a cash basis and have no application to returns filed on an accrual basis under S13 (d) and S10 of the 1916 Act as amended by S4 of the 1917 Act which imposes the tax on the total net income received from all sources by every corporation and prescribes a rate of income tax. Section 12 (a) defines how such net income shall be ascertained and refers to net income made taxable by S10. The only definition of net income which is subject to tax, upon any basis, is that defined in S12 (a). Reading these sections together it will be observed that the provisions referring to income received and expenses paid mean received or paid in accordance with the principle upon which the books are kept. Section 12 (a) and S13 (d) must be read together and in so doing the taxing scheme of the statute is plain. (*United States* v. *Anderson,*

269 U. S. 422; *Amer. National Co., etc.,* v. *United States,* 274 U. S. 99.) In the *Anderson case* the Commissioner disallowed as a deduction from the taxpayer's 1917 gross income, computed upon an accrual basis, munitions tax paid in 1917 but which had accrued in 1916. In supporting such action the Supreme Court recognized that the taxes were there computed, not upon the income as returned, but upon the income corrected to accord with the basis upon which the taxpayer's accounts were kept. In *Aluminum Castings Co.* v. *Routzahn, supra,* it was conceded that the books were kept upon an accrual basis and it was pointed out that the Commissioner had the right to eliminate a deduction wrongfully made.

In *American Can Co.* v. *United States,* 31 Fed. 730 (C. C. A. 3), the court took a view of the questions here presented which is contrary to our conclusions. We find ourselves unable to agree with the reasons advanced by that learned court which persuaded them. The appellants' returns did not truthfully state their income due to the bookkeeping entries which covered an increased valuation over the cost of the tin plate and they have failed to bear the burden of establishing the invalidity of the tax which has been assessed. (*Botany Worsted Mills* v. *United States,* 278 U. S. 282; *United States* v. *Mitchell,* 271 U. S. 9.) The Commissioner has but taxed income in declining to allow this alleged increase of cost. The taxpayer received a gain in the sale of its tin plate, when made into tin cans, to the extent of this increase. It was gain derived from capital and labor or from both combined. (*Taft* v. *Bowers,* 278 U. S. 470; *Merchants Loan & Trust*

Co. v. *Smietanka,* 255 U. S. 509; *Doyle* v. *Mitchell Bros.,* 247 U. S. 179.) Indeed, the appellants have failed to comply with the Departmental Regulation 33 (Revised), Articles 91 and 92, promulgated under the Act of 1917, which, in effect, require manufacturing and mercantile corporations to compute their income tax under the act in question through the use of inventories showing gross income as consisting of the difference between the price received for the goods sold and the cost of such goods as manufactured. Such regulations are valid, whether applied to a cash or accrual basis of return. (*Hays* v. *Gauley Mt. Coal Co.,* 247 U. S. 189.)

The court below properly directed a judgment for the defendant in each case.

Judgments affirmed.

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